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In the Supreme Court of the United States

OCTOBER TERM, 1962

No. 708

WHITE STAG MANUFACTURING COMPANY,
Petitioner-Appellant,

v.

DEAN ELLIS, F. H. W. HOEFKE and CHARLES MACK, members of and constituting the State Tax Commission of the State of Oregon,
Defendants-Appellees.

On Appeal from the Supreme Court of the State of Oregon

MOTION TO DISMISS

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DEAN ELLIS, F. H. W. HOEFKE and CHARLES MACK, members of and constituting the State Tax Commission of the State of Oregon.

Defendants-Appellees.

On Appeal from the Supreme Court of the State of Oregon

MOTION TO DISMISS

Defendants-appellees, herein called defendants, pursuant to Rule 16 of the Revised Rules of the Supreme Court of the United States, move that the appeal from the decree of the Supreme Court of the State of Oregon be dismissed on the grounds that the court should not invoke jurisdiction under 28 U.S.C. § 1257(2), and for the reason that it does not present a substantial federal question.

STATEMENT OF THE CASE

Plaintiff-appellant, herein called plaintiff, has set forth the memorandum opinion of the trial court, supplemental memorandum opinion of the trial court, opinion of the Supreme Court of Oregon, decree of the Supreme Court of Oregon, Oregon statutes, regulations of the

State Tax Commission of Oregon and a statement of the case in its jurisdictional statement. The statement of the case can be exceedingly simplified by presenting only the operative facts.

Oregon, under its laws and regulations, applies the three factor or "Massachusetts" formula to apportion to Oregon for excise tax purposes the net income of a unitary business subject to Oregon tax. The formula is expressed thusly:

$$\text{Net Taxable Income} \times \frac{\text{Oregon property}}{\text{Total property}} \times \frac{\text{Oregon wages}}{\text{Total wages}} \times \frac{\text{Oregon Sales}}{\text{Total Sales}} \text{ equals}$$

Net Taxable Income Earned in Oregon (Apportioned)

The nub of the controversy is that plaintiff contends the total property factor and the total wage factor should include the property and wages of certain third parties with whom they do business. The inclusion would reduce the apportionable net income subject to tax in Oregon. Both the trial court and the Supreme Court of Oregon held that the business activities of third parties were not the business activities of plaintiff, and therefor had no part in determining what plaintiff's net income was for the tax years ending November 30, 1956 and 1957.

I

THE SUPREME COURT OF THE UNITED STATES SHOULD NOT INVOKE JURISDICTION OF THIS APPEAL UNDER 28 U.S.C. § 1257(2)

28 U.S.C. § 1257(2) provides for jurisdiction in the Supreme Court of the United States "* * * where is drawn in question the validity of a statute of any state

on the ground of its being repugnant to the Constitution, or treaties or laws of the United States, and the decision favors its validity."

In the present instance the plaintiff has not denied the jurisdiction of the State of Oregon to tax a corporation doing business both within and without the state on its net income earned within the state. On the contrary, plaintiff's objections are to the amount of tax it must pay as determined under the apportionment formula known as the "three factor" or "Massachusetts formula" stated thusly:

$$\text{Net Taxable Income} \times \frac{\text{Oregon property}}{\text{Total property}} \times \frac{\text{Oregon wages}}{\text{Total wages}} \times \frac{\text{Oregon Sales}}{\text{Total Sales}} \text{ equals}$$

Net Taxable Income Earned in Oregon (Apportioned)

To this apportioned net income is applied the rate of tax which applies to corporation income under Oregon Revised Statutes Chapter 317.

It is true that plaintiff alleged in its complaint in the Circuit Court of Multnomah County, Oregon, that the State Tax Commission, in refusing to consider the business activities of third parties to be the business activities of the plaintiff, had violated the equal protection of laws and due process clauses of the Fourteenth Amendment to the Constitution of the United States, and also had violated Art. I, § 8, c. 3, the commerce clause of that Constitution. Such allegations are not allegations that the statute itself (ORS 317.180) or the regulations of the State Tax Commission thereto (Reg. 7.180(1)-(B) and 4.280(1)-(B) are invalid, and are insufficient as grounds for an appeal under 28 U.S.C. § 1257(2)). *Rohr*

Aircraft Corp. v. County of San Diego et al., 362 U.S. 628, 80 S. Ct. 1050 (1960); *Charleston Federal Savings & Loan Association v Alderson*, 324 U.S. 182, 185 (1945).

Neither the Oregon circuit court nor the Oregon Supreme Court based its decision on the question of the validity of the statute in question, but rather on the nonfederal grounds that the plaintiff could not include in determining its net income subject to Oregon excise tax, wages paid and property owned by third parties independent of plaintiff. The Oregon circuit court said (pp. A9 and A10 Jurisdictional Statement, last paragraph):

> "The State Tax Commission has made a regulation setting forth that payments to bona fide independent contractors cannot be included in the formula. It is not necessary to determine whether or not the manufacturers in this case are, or are not, independent contractors. It is the opinion of the Court that in fulfilling the purposes of the formula there cannot be included in any of the three factors, amounts paid by a taxpayer to other individuals or companies as was done by plaintiff in this case; whether they be independent contractors or not. Wages paid by the manufacturer to employees and estimated property costs of manufacturers are not an activity of the taxpayer company to be considered in determining where its income is earned. Therefore, in this case it is held that the amount sought to be included in the formula by the plaintiff corporation which they estimate were paid to the manufacturers for the manufacturers' employees' wages and cost of property do not reflect activities of the plaintiff corporation that produce income and should not be included in the formula."

Thus, it can be seen that the court did not find it necessary to uphold or consider the validity of the statute to reach its decision. The Oregon Supreme Court in its opinion (p. A20 Jurisdictional Statement) states:

> "* * * It follows that wages paid by the contractors and their estimated property costs are not activities which can properly be considered in determining where plaintiff's income is earned."

This Court has repeatedly held that before it will review a decision of a state court, it must affirmatively appear from the record that the federal question was presented to the highest court of the state having jurisdiction *and that its decision of the federal question was necessary to its determination of the cause.* See *United States v. Commonwealth of Pennsylvania*, 89 Fed. Supp. 636 (1950).

In fact, where the state Supreme Court *might* rest its decision on adequate state grounds, this Court will not take jurisdiction or review that judgment. *Stembridge v. Georgia*, 343 U.S. 541, 72 S. Ct. 834, 96 L. Ed. 1130 (1952); *Ellis v. Dickson et al.*, 349 U.S. 458, 75 S. Ct. 850, 99 L. Ed. 1231 (1955).

The tax assessments protested by plaintiff are for the fiscal years ending November 30, 1956 and 1957. The objectionable feature of Reg. 4.280(1)-(B), the validity of which plaintiff questions (p. 5 Jurisdictional Statement) is the section of the regulation that states that "Payments made to bona fide independent contractors employed by a taxpayer are not included in the wage factor." This regulation was not promulgated until January 20, 1959 and could not therefore have any

effect on the plaintiff's 1956 and 1957 taxes. The above addition to the regulation, if it changed the existing laws applied to plaintiff's tax liability, would be invalid. Agencies have no powers except those conferred and power to issue retroactive rules is not easily implied. Davis, Administrative Law Treatise, Vol. 1, § 5.08. If the addition to the above regulation is an interpretive rule and if the meaning of the statute has been there from the time of its original enactment, then the interpretive rule expresses the true meaning of the statute and that is what the statute has always meant. The validity of such a regulation as set out above and applied to prior tax assessments is therefor moot. *Manhattan General Equipment Co. v. Commissioner*, 297 U.S. 129, 56 S. Ct. 397, 80 L. Ed. 528 (1936).

The opinion of the Supreme Court of Oregon mentions independent contractors (p. A20 Jurisdictional Statement) but the court's opinion indicates that the property and wages of third parties are not part of plaintiff's business, not because of the regulation, but because the plaintiff had no proprietary interest or control thereof (p. A22 Jurisdictional Statement), citing *Hines Lbr. Co. v. State Tax Commission*, 215 Or. 453, 475, 336 P.2d 75 (1959).

II

THE APPEAL DOES NOT PRESENT A SUBSTANTIAL FEDERAL QUESTION

A. "Due process is not violated".

As plaintiff points out (p. 16 Jurisdictional Statement) it has been unable to discover a reported case with

a factual situation comparable to the instant case. This is true because the contentions of plaintiff are frivolous and without merit. Plaintiff's explanation of why a review of this case should be made (pp. 17, 18 Jurisdictional Statement) results in a conclusion not warranted by the facts. Plaintiff states (p. 18 Jurisdictional Statement):

> "* * * The Oregon corporation excise tax is 6 per cent of net income. Under the decision of the Oregon Supreme Court, two Oregon corporations engaged in the business of manufacturing and selling goods within and without the state and having equal net income would pay materially different amounts as excise taxes in case one did its out of state manufacturing in its own plants and the other had goods manufactured out of its own materials, according to its own designs and specifications and under its supervision in plants owned and operated by third parties. * * *"

Oregon applies the same rate of tax to the net income of either corporation in the example given by plaintiff so the result would be parity. The only variables which might explain the difference in the tax between the two hypothetical corporations posed by the plaintiff is that plaintiff has added the fees paid to third parties to one of the corporation's activities in the example, and not to the other.

This Court has ruled the three factors formula as used by Oregon in determining apportionable net income subject to excise taxation a fair and reasonable way of allocating the income of a unitary business to the state. *Butler Bros. v. McColgan*, 315 U.S. 501, 507, 625

S. Ct. 701, 86 L. Ed. 991 (1942). Thus, a 6 percent rate applied to this business could not result in a discrimination between it and a business wholly intrastate since in either plaintiff's case or in an intrastate business, equal net income would result in equal taxation under the Oregon formula. The case of *Royster Guano Co. v. Virginia*, 253 U.S. 412, 40 S. Ct. 560, 65 L. Ed. 989 (1919), cited by plaintiff, is completely distinguishable. (p. 19 Jurisdictional Statement).

The fallacy in plaintiff's example (p. 18 Jurisdictional Statement) is characterizing fees paid third parties as plaintiff's own activities. The conclusion by plaintiff (p. 21 Jurisdictional Statement) that Reg. 4.280(1)-(B) imposes a higher tax on plaintiff than it would impose on an Oregon corporation having the same Oregon income but doing no out-of-state business is without authority and contrary to judicial precedent. Oregon has jurisdiction to tax and its measure reaches only income earned in Oregon. Due process asks no more.

This can be perceived by examining Reg. 4.280(1)-(B) which is essentially the apportionment method approved by this Court in *Butler Bros. v. McColgan, supra; Underwood Typewriter Co. v. Chamberlain*, 254 U.S. 113 (1920). See also *A. C. Dutton Lbr. Co. v. State Tax Commission*, 228 Or. 525, 531, 364 P.2d 867 (1961); *Edison California Stores v. McColgan*, 30 Cal.2d 472, 183 P.2d 16 and *El Dorado Oil Works v. McColgan*, 34 Cal.2d 731, 215 P.2d 4, appeal dismissed, 340 U.S. 801, 71 S. Ct. 52 (1950).

The impact of these cases is that Oregon's apportionment formula meets the test of "due process".

B. **The "commerce clause" is not violated.**

The only judicial citation plaintiff has been able to produce to support its theory that Oregon's apportionment formula, as applied to plaintiff, violates Art. I, § 8, c. 3 of the commerce clause of the United States Constitution is *Hans Rees' Sons, Inc. v. State of North Carolina*, 283 U.S. 123, 135, 51 S. Ct. 385 (1931). It will be recalled that the *Hans Rees'* case concerned the use of a single apportionment factor, property, found to be unreasonably applied. This differs patently from the instant case in that Oregon uses the three factor formula which has never been successfully challenged as a reasonable measure of allocation where tax jurisdiction is present.

The legal principle applied to determine whether a measure is constitutional in regard to the commerce clause is whether or not the measure tends to place interstate commerce at a competitive disadvantage, *McGoldrick v. Burwind White Co.*, 309 U.S. 33, 45, 60 S. Ct. 388, 88 L. Ed. 565 (1940), which is equal to the test of whether or not interstate commerce is being discriminated against.

The same principle is restated in a different way in *Memphis National Gas Co. v. Stone*, 335 U.S. 80, 88, 68 S. Ct. 1425, 92 L. Ed. 1832 (1948):

> "A glance at the activities named above [local activities in maintaining and keeping in repair and

otherwise in manning 135 miles of pipeline in Mississippi| shows that there is no possibility of multitaxation to the same exaction by the states. The amount of the tax is reasonable. It is properly apportioned to the investment in Mississippi." (Bracketed material added)

The Mississippi tax was imposed on the activities named, and was measured by $1.50 for each $1,000 of value of property employed in Mississippi. The measure of the tax included interstate business, since the parties stipulated that no intrastate business was done. This Court sustained the measure however when it sustained the taxes as being properly imposed on a local "incident". The concurring opinion, at page 96, explains that though interstate business was included in the measure, the tax was not an unreasonable burden on interstate commerce. An unreasonable burden philosophy is another way of stating that interstate commerce cannot be placed at a competitive disadvantage or discriminated against or subjected to multiple taxation: Oregon's tax formula violates none of these tests.

In *Matson Navigation Co. v. State Board*, 297 U.S. 441, 56 S. Ct. 553, 80 L. Ed. 791 (1936), California had sustained a privilege tax measured by net income from all sources of business done within the state, whether foreign, domestic or intrastate. The taxpayer was a domestic corporation but the measure was not sustained for that reason. The Court declared on page 444:

"* * * A net income justly attributable to all classes of business done within the state may be used as a measure of a tax imposed to pay the state

for the use therein of the corporate franchise granted it."

The corporate franchises referred to included the franchise to do business rather than merely the charter granted, for the Court cited as its authority, *Bass, Ratcliff & Gretton, Ltd. v. State*, 266 U.S. 271, 45 S. Ct. 82, 69 L. Ed. 282 (1924), and *Underwood Typewriter Co. v. Chamberlain, supra*, both of which involved foreign corporations.

Following the *Matson* case, *Ford Motor Co. v. Beauchamp*, 308 U.S. 331, 60 S. Ct. 273, 84 L. Ed. 304 (1939) applied the same principle to a foreign corporation, holding that a state's power to tax foreign corporations is as unrestricted as that for domestic corporations as far as the commerce clause is concerned and it sustained a "doing business" privilege tax using gross receipts as a measure of capital employed in the taxing state (Texas). The taxpayer contended that the measure was unreasonable since it reached assets employed in interstate commerce. This Court held the imposition was properly laid on an intrastate privilege and the measure thereof was reasonable since it was limited to property within the taxing jurisdiction.

The foregoing principles and other objections to Oregon's type of measure had been resolved in favor of state taxation very early in the *Underwood Typewriter* case, *supra*, where Mr. Justice Brandeis declared at page 119:

"It is contended that the tax burdens interstate commerce, and hence is void, under section 8 of

article 1 of the federal Constitution. Payment of the tax is not made a condition precedent to the right of the corporation to carry on business, including interstate business. Its enforcement is left to the ordinary means of collecting taxes. Saint Louis S. W. Ry. Co. v. Arkansas, 235 U.S. 350, 364, Atlantic & Pacific Telegraph Co. v. Philadelphia, 190 U.S. 160, 163. The statute is, therefore, not open to the objection that it compels the company to pay for the privileges of engaging in interstate commerce. A tax is not obnoxious to the commerce clause merely because imposed upon property used in interstate commerce, even if it takes the form of a tax for the privilege of exercising its franchise within the state. Postal Telegraph Cable Co. v. Adams, 155 U.S. 688, 695. This tax is based upon the net profits earned within the state. That a tax measured by net profits is valid, although these profits may have been derived in part, or indeed mainly from interstate commerce, is settled. U.S. Glue Co. v. Oak Creek, 247 U.S. 321, Shaffer v. Carter, 252 U.S. 37, 57; compare Peck & Co. v. Lowe, 247 U.S. 165. Whether it be deemed a property tax or a franchise tax, it is not obnoxious to the commerce clause."

The same conclusion was reached in the *International Shoe Co. v. Shartel*, 279 U.S. 429, 49 S. Ct. 380, 72 L. Ed. 781 (1928) at page 433:

"* * * A franchise tax imposed on a corporation, foreign or domestic, for the privilege of doing a local business, if apportioned to business done or property owned within the state, is not invalid under the commerce clause merely because a part of the property or capital included in computing the tax is used by it in interstate commerce. * * *"

That Oregon has not allowed plaintiff to include in its apportionment formula property owned or wages paid

by independent third parties, could not conceivably raise the question of burdening interstate commerce nor a substantial federal question.

CONCLUSION

The allocation formula employed by Oregon measures plaintiff's tax in the same manner it measures the tax of any other corporation doing business in Oregon, whether foreign or domestic. The cases presented demonstrate that a state's allocation formula for measuring a properly imposed privilege tax can constitutionally include intrastate and interstate business done within the state as the measure, but there is no federal question where the highest court of the state refuses to allow plaintiff to include in that formula wages paid and property owned by parties other than the plaintiff. Plaintiff's tax liability is measured only by its own activities. Oregon's tax need not be paid as a condition of doing business in Oregon; it places no bar on interstate operations and is collected through ordinary means. Oregon's formula, as applied, can never reach income earned outside of Oregon so as to be violative of due process. The commerce clause, under the facts presented, requires that plaintiff not be given less favorable treatment by Oregon than is given local commerce. This Oregon has done under a formula which is demonstratively fair and reasonable.

It is respectfully submitted that the opinion of the

Oregon Supreme Court be sustained and that the appeal of plaintiff herein be dismissed.

Respectfully submitted,

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